

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Implementation of Section 6002(b) of the)	
Omnibus Budget Reconciliation Act of 1993)	WT Docket No. 09-66
)	
Annual Report and Analysis of Competitive)	
Market Conditions With Respect to Mobile)	
Wireless including Commercial Mobile)	
Services)	

Reply Comments of Steven A. Zecola

I. Introduction

The Comments in this proceeding have shown that the structure of the mobile wireless market is workably competitive, but that competition is not working effectively for consumers.

In fact, Verizon's expert witness has provided irrefutable evidence that the dominant carriers are colluding on price. As a result of this price collusion, competition has moved to other areas. For example, AT&T and Verizon have become the biggest ad spenders in the United States. Non-price competition can also be seen by the growth in related areas such as tower construction or the number of retail locations selling cell phones.

Despite inflated cost structures, AT&T's and Verizon's wireless profits are extraordinarily high and growing rapidly. For example, their cash operating margins are higher than any company listed in the Fortune 1000.

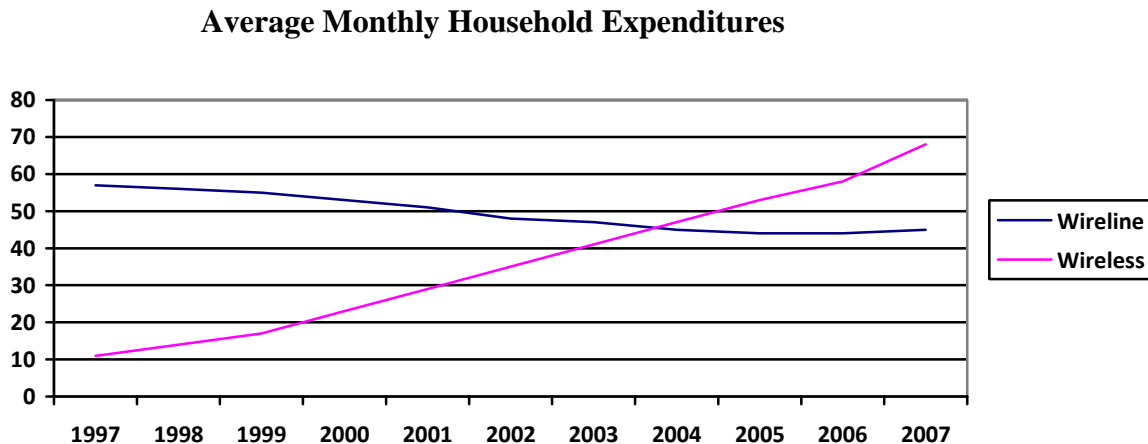
If mobile services were offered in a competitive market where price and cost leadership were the primary success factors, competition would drive costs, margins and prices down significantly.

But AT&T and Verizon have systematically undermined competition and have acted to avoid head-to-head competition. Extrapolating the current revenue trends, consumers will be overcharged by up to \$1 Trillion over the next decade relative to what the prices would be in a fully competitive mobile services market.

Given AT&T's and Verizon's dominant market position, their repeated violations of the FCC's pro-competitive requirements, their history of antitrust abuses, their close industry relationship, the current lack of rigorous competition between their wireline and wireless services and the lack of mobile price competition, the FCC should institute a formal investigation into AT&T's and Verizon's pricing and market entry practices – or refer the matter to the Department of Justice.

II. The Actual Price for Mobile Service Is the Key Public Policy Issue

The FCC's Reference Book for Telephone Service (2008) provides the following information for wireless and wireline spending:



The chart shows that households spend well over \$60 per month on wireless services, and this number is growing rapidly. On the other hand, households spend less than \$50 per month on wireline service, and this number is declining. These expenditures reflect the price of mobile service multiplied by the quantity of services purchased by customers (or in economic terms, price times quantity).

In this proceeding, the public interest findings must be premised upon the actual prices that consumers pay for mobile service, not the expenditures for service or other derived metrics.

The traditional definition of price is the monetary value that is applied to a definite measure of a good or service. In this context of this proceeding, the price for mobile service is equivalent to the monetary value that is put into the billing system for each service element (e.g., the amount that would appear on a rate card or tariff for a specific billed element or service).

In contrast, price is not the market value that is derived by “adjusting” the actual price or by dividing it by a variable that does not reflect the measure for the service, as the dominant carriers argue.

For example, if a person purchases 60 minutes of calling for \$6.00, the price is \$6.00, not 10 cents a minute. Similarly, if the person utilizes only 30 minutes of the aforementioned bucket of minutes, the price is still \$6.00, not 20 cents per minute. The unit of measure in this example is 60 minutes, not one minute.

Similarly, when a mobile service provider charges \$99 per month for unlimited usage, the price is \$99.00. The price is not the amount determined by dividing \$99 by the number of minutes utilized by any one user or group of users.

Certainly, if AT&T and Verizon prefer to charge for mobile service on a per-minute basis, they are free to do so. But instead, they utilize fixed access fees as the pricing mechanism that is the major contributor to their revenue.

III. The Evidence Shows the Carriers are Colluding on Mobile Prices

As an attachment to its pleading, Verizon provides an economic analysis by Michael D. Topper. Mr. Topper provides the following information in Table 3, page 66 of his testimony.

Voice Pricing Plans

<u>Minutes</u>	<u>Price</u>		<u>Minutes</u>	<u>Price</u>
AT&T:			Verizon:	
450	\$39.99		450	\$39.99
900	\$59.99		900	\$59.99
1350	\$79.99		1350	\$79.99
Unlimited	\$99.99		Unlimited	\$99.00
Sprint:			T-Mobile:	
200	\$29.90		300	\$29.99
450	\$39.99		600	\$39.99
900	\$59.99		1000	\$49.99
Unlimited	\$99.99		Unlimited	\$99.99

What is striking about this chart is that AT&T's and Verizon's price structure and actual prices for each element are identical. Additionally, Sprint and T-Mobile have very similar structures and prices to AT&T and Verizon, although they have somewhat lower prices for the smaller users.

But that is only half the issue. AT&T and Verizon also have the identical per-minute charges of \$0.35, \$0.40 and \$45 when users go over the minute allowance of the three lower-volume plans.

These prices reflect a nearly perfect example of price collusion, which should be deeply troubling to the Commission. The FCC should subpoena AT&T Mobility's and Verizon Wireless' internal pricing documents and depose their key executives regarding these prices.

The FCC should also gather information on the actual rate elements charged by AT&T and Verizon to their ten largest customers. Similarly, the FCC should request the GSA to provide it with the carriers' bids on GSA's three largest mobile procurements. This information will provide evidence whether the carriers are also colluding in the business segment of the market, and if not, it will provide an indication of the effects of competition.

As an aside, a comparison of AT&T's and Verizon's pleadings shows significant parallels,

implying close coordination. The same cannot be said for any other commenting parties. This behavior speaks to the overall level of coordination and cooperation between these two dominant carriers, which should be addressed as part of an Investigation Order.

IV. AT&T's and Verizon's Mobile Prices are Not Falling

AT&T and Verizon take the position that their prices are falling. For example, AT&T's witness,

Robert D. Willig, states: "Per-minute charges to subscribers continue to decline" and Verizon's

expert, Michael T. Booker, states: "consumers are realizing substantial benefits in terms of lower prices".

First, as Mr. Booker has shown in Table 3 of his Declaration, the main price element of the carriers' pricing plans is a flat access fee, not per-minute charges. Therefore, Mr. Willig's reference to "per-minute charges" is a mischaracterization of the facts.

Moreover, Mr. Booker and Mr. Willig do not address the actual price elements that AT&T and Verizon input into their billing systems. The Commission should request that the record be supplemented with these price elements along with the amount of revenue from each price element. The Commission will find that the majority of the carriers' revenue comes from fixed access fees.

Second, it appears that these witnesses have not looked at the carriers' price elements on an historic basis. For example, Bell Atlantic Mobility posted the following prices on its website in 1998:

1998 - Rate Plans for Washington/Baltimore

	DigitalChoice	DigitalChoice	DigitalChoice	DigitalChoice	DigitalChoice
		20	100	400	800
Monthly Access	\$14.99	\$19.99	\$39.99	\$59.99	\$99.99
Home System Airtime Minutes Included	0	20	100	Peak 200 Off-Peak 200	Peak 400 Off-Peak 400
Additional Airtime Minutes	35¢	30¢	Peak 30¢ Off-Peak 15¢	Peak 30¢ Off-Peak 10¢	Peak 28¢ Off-Peak 10¢
Cellular Long Distance/ Regional Calling Rate (per minute)	Peak 21¢ Off-Peak 9¢	Peak 21¢ Off-Peak 9¢	Peak 21¢ Off-Peak 9¢	Peak 21¢ Off-Peak 9¢	15¢

Again, the results are striking when compared to today's prices. Verizon has eliminated the two low-price tiers, and incorporated the prices in the three top tiers in its current price structure – more than 11 years later. That is, the fixed access prices have gone up for low volume users and these prices have remained flat for the larger users. Additionally, the prices for "additional airtime minutes" are higher today than

they were 11 years ago.

While AT&T and Verizon allow more minutes under certain plans than they did 10 years ago, this doesn't mean the price is lower or that competition is working effectively. As Mr. Booker repeats over 10 times in his testimony, wireless has "significant fixed costs". Therefore, the carriers are maintaining high prices by simply offering an added benefit to consumers that has a very low marginal cost to the carriers.

AT&T and Verizon also both point to significant price declines in pre-paid plans as evidence of price competition. However, the actual prices for the pre-paid plans include a fixed access fee of \$40 to \$45. These lower prices reflect the lower cost of pre-paid customers and therefore do not reflect price competition. For example, the practice of requiring pre-payment decreases the costs of bad debt, fraud and billing, and improves cash management. The FCC should subpoena AT&T's and Verizon's internal product line profitability studies for pre-paid services to gain a better understanding of this issue.

AT&T and Verizon also point to resellers as proof of vigorous competition. This argument is misguided. Resellers represent a sales distribution channel, typically into a segment of the market in which the carrier is underperforming. The Commission should subpoena AT&T's and Verizon's cost studies to determine how the price discounts to resellers compare to AT&T's and Verizon's cost savings for sales and marketing to the targeted end users.

V. AT&T's and Verizon's Mobile Costs, Profits and Prices Are Unreasonably High

The evidence shows that not only are profits extremely high for AT&T's and Verizon's wireless business units, but non-price competition has led to their cost structure being inefficient as well.

For example, AT&T and Verizon are the biggest ad spenders in the United States, each spending over \$2 Billion per year. For purposes of comparison, the U.S. automobile industry doesn't spend as much on advertising as does AT&T or Verizon.

In addition to ad spending, AT&T Mobility and Verizon Wireless spend excessively on customer-facing activities. For example, a recent press release said:

"AT&T today announced it has revamped its more than 2,200 retail locations across the country...As part of the makeover, AT&T has transformed its AT&T-owned stores to feature a refreshed, more intuitive organization of products and services...The makeover builds on significant investments AT&T has made over the past 18 months since AT&T's merger with BellSouth and acquisition of Cingular Wireless".

In addition to advertising and running their own retail outlets, AT&T Mobility and Verizon Wireless pay excessive commissions to retailers such as Radio Shack and to various sales agents.

AT&T and Verizon are inefficient on a capital basis as well. We know that networks become more efficient with customer growth for two reasons. First, many network costs are fixed in nature. Second, network components are dropping in price and increasing in capacity.

Nevertheless, Verizon's latest annual reports show assets of \$112 Billion for the wireless business unit, or about \$1700 per subscriber. Of this, Verizon reports \$62 Billion for wireless licenses, presumably representing excessive payments for licenses in acquisitions or at auction.

For purposes of comparison, Clearwire put together a nationwide spectrum footprint for a small fraction of this amount. Moreover, it is worth noting that the Bell Operating Companies, including Southwestern Bell, NYNEX and Bell Atlantic, received 25 MHz of prime cellular spectrum from the FCC at no cost.

The capital cost to build an efficient, large-scale wireless network is less than \$500 per sub. For example, Verizon reports net property, plant and equipment for its wireless unit at \$27 Billion or about \$410 per sub. In competitive markets, assets are valued at their replacement cost. The magnitude of the difference between Verizon's booked wireless assets and their replacement cost shows the massive distortion occurring in the market.

In terms of variable costs, the biggest categories of expense are handheld devices, sales, marketing, customer service and billing. The costs for all of these categories vary per customer, not per-minute or per-customer-per-minute. As the number of subscribers grows, even these variable costs should be experiencing significant efficiencies over time. Certainly, these efficiencies occur in other industries, resulting in lower prices.

For example, the web hosting industry is similar to wireless in terms of being network-centric and relying upon sales and marketing as key factors to success. Web hosting also experienced large increases in customers, and also incurred large increases in usage per customer. However, there were no barriers to entry and the market was fully competitive. Under these conditions, prices per customer dropped significantly to a floor set by the efficient, low-cost operators, and as usage increased, more features and functions were added, but prices remained low.

By this or any other measure of comparison, AT&T's and Verizon's cost structure is extraordinarily inefficient.

Additionally, AT&T's and Verizon's profit margins are excessive and literally unsurpassed in corporate America. For example, Verizon reports earnings before depreciation of \$19.3 B per year, or more than 40% of revenue. In other words, Verizon recovers the entire net cost to build its wireless network every 19 months. AT&T's cash operating margin for mobile service is even higher.

In comparison, no company in the Fortune 500 reports cash flow margins of 40%, and only a handful report margins over 30%. For example, Google reports a cash flow margin of 36% resulting from the power of its proprietary search and ad placement software.

Both AT&T's witness and Verizon's witness state that marginal costs and accounting costs are inappropriate to use to determine their client's profitability. They do not offer an alternative method, other than to suggest that the Commission ignore the issue. But rather than ignoring the issue, the FCC should request AT&T Mobility and Verizon Wireless to submit into the record the amount of additional cash that they have accumulated over each of the last four quarters.

Neither economic cost nor accounting cost methodology is required to provide this information.

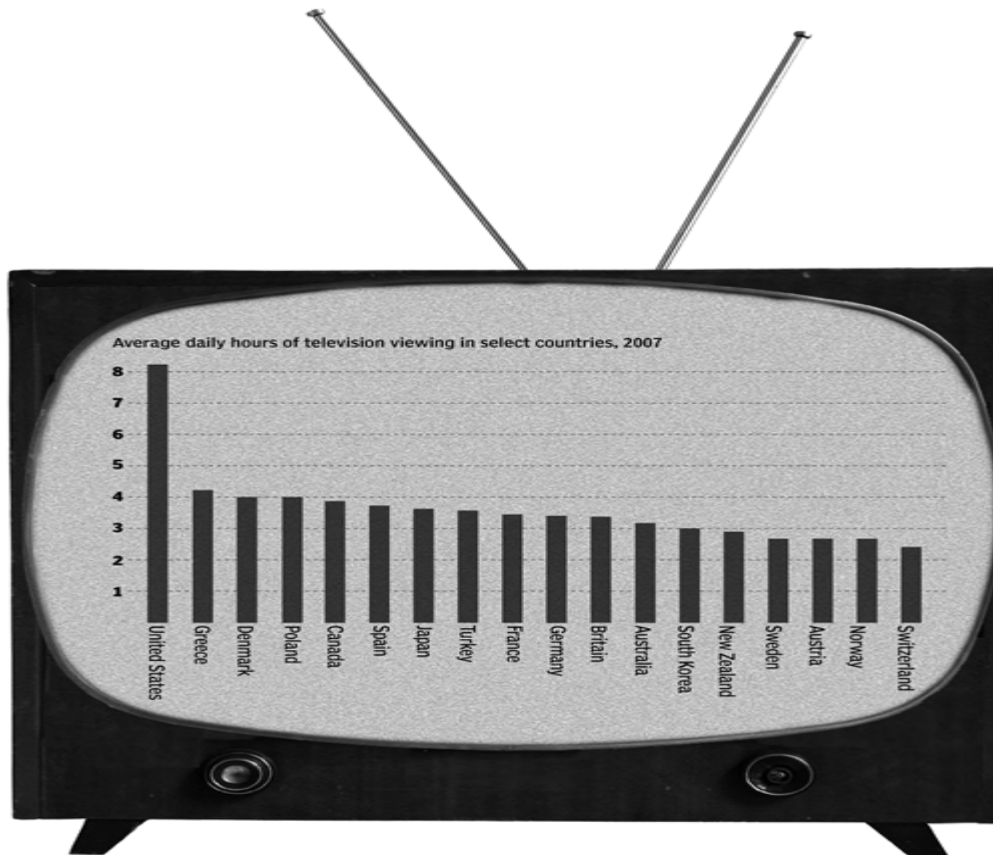
AT&T and Verizon also point to several studies by Morgan Stanley to demonstrate the alleged competitive nature of the wireless market. The Commission should request Morgan Stanley to compare the cash flow margins of AT&T Mobility and Verizon Wireless (before and after network expenditures) to each company in the Fortune 1000 and submit that information into the record of this proceeding.

With excessive costs and profits, AT&T's and Verizon's prices are also unreasonably high. While AT&T and Verizon have argued that mobile prices are five cents on a per-minute basis, the carriers generally do not price on a per-minute basis and the vast majority of their costs do not vary on a per-minute basis. For example, AT&T's and Verizon's pricing plans typically have a \$40 to \$100 fixed monthly charge for access, reflecting the fact that most of their costs are either fixed or customer-dependent.

The only situation where AT&T and Verizon charge on a per-minute basis occurs when customers go over their fixed allotment of minutes. As mentioned previously, the prices in these situations range from \$0.35 to \$0.45 per minute, not 5 cents per minute.

The absurdity of AT&T's and Verizon's argument can be seen by comparing the analogous fact set from the Cable TV industry. We know Cable TV prices are higher in the United States than other countries, but the following chart also shows that we lead the world in the number of hours spent watching TV.

Average Daily Hours of Television Viewing in Select Countries



AT&T's and Verizon's analysis would be mimicked for the cable industry by dividing the average Cable TV prices in various countries by the hours of daily viewing in those countries. This analysis would show Cable TV prices per hour of viewing in the United States to be the lowest in the world. But then again, it would be a meaningless statistic because CATV costs don't vary by the number of hours viewed, and they aren't priced on that basis either.

Similarly, the comments of Gregory L. Rosston and Michael D. Topper go so far as to say wireless market has produced enormous price reductions given the calculations for price-per-minute over time. However, these calculations don't reflect the actual price of service to consumers. For example, if AT&T paid these two economists a retainer of \$15,000 a month for two years to participate in this proceeding and the amount of their work doubled in the second year, their price for service would not have been cut in half. Rather, the price for their service would have remained constant at \$15,000 a month.

In the case of mobile communications, the actual prices for access and additional airtime have stayed constant or increased for more than a decade, despite the conditions present to enable enormous cost efficiencies and price reductions.

The unadjusted facts show that AT&T Mobility and Verizon Wireless have: a) unreasonably high prices, b) bloated costs as a result of non-price competition and c) excessive profits.

The Commission should subpoena AT&T's and Verizon's internal cost and pricing studies to

uncover several revealing facts such as the marginal cost of an increase in minutes per subscriber and to ascertain the underlying rationale behind these carriers' pricing decisions.

VI. Excessive Mobile Prices Impose a \$75 Billion Tax on Consumers Per Year

In a fully competitive market, unrestricted market forces would cause mobile prices to drop to a level that allows a reasonable return on investment given the level of risk. With capital costs of \$400 per subscriber and cash flow margins of 20% (assuming a more traditional sales and marketing expense for technology companies of 15-20% of revenue), mobile prices would drop below \$30 a month. In this scenario, the capital cost of building the wireless network would be paid off in less than six years, reflecting a business that would yield attractive returns to capital.

The FCC should not be swayed by cries that such an outcome is not feasible. AT&T and Verizon have an average life per wireless customer of well over five years. With high prices and 40% margins, they are incited to spend wildly to get customers. However, if unfettered competition limited these carriers to \$27 per month in revenue and with sales and marketing costs at 17.5% of revenue, they would still be able to spend over \$300 per customer to acquire new subscribers. The wireless carriers could achieve this metric simply by using the Internet more effectively to sell service, as is occurring in almost every other industry.

Another factor for the Commission to consider is that competitive mobile pricing below \$30 per month would put pressure on the landline networks to respond with lower pricing or better services, providing additional benefits for consumers. For example, landline carriers could resell mobile service and offer a bundled service. Certainly, the Cable TV providers are going down this road.

The net result of AT&T's and Verizon's practices is that consumers are overpaying up to \$75 Billion per year for mobile services compared to what pricing would be in a fully competitive market. Given the growth in expenditures shown in the chart in Section II above, these overpayments could reach \$1 Trillion over the next decade without regulatory remedies.

VII. AT&T and Verizon Dominate the Telecom Market, including Mobile Wireless

Reasonable people can differ on the contours of a relevant market in a particular sector of the economy such as communications. Additionally, conditions can and do change over time which change the contours of the market. For example, substitution is beginning to occur with respect to video distribution so we can expect additional changes in market definitions in the not too distant future.

In looking at the relevant market for mobile communications, the first set of facts for the FCC to address is that 20% of subscribers have already substituted mobile service for wireline service, despite shoddy in-door service. Second, at competitive rates and good quality, market research shows that 70% of consumers would prefer bundled service for their mobile, local and long distance requirements. Third, the two dominant carriers understand the substitutability between wireless and wireline and plan their actions accordingly. Fourth, increases in the price of either wireless services or landline services (local, long distance, calling cards, and payphones) affect

the degree of substitution between wireless and wireline services. Given these market realities, the relevant market for analyzing mobile communications should encompass the overall telecom market (local, long distance and mobile).

Nevertheless, irrespective of precise boundaries of the relevant market, the FCC has to consider the dynamics of the entire telecom market, especially including the overall dominance of AT&T and Verizon, in analyzing mobile communications.

In particular, AT&T and Verizon capture about 60% of the revenues for mobile communications. Of the overall telecom market, AT&T and Verizon capture about a 70% market share.

Looking at the market capitalization of the telecom market, AT&T and Verizon capture almost 80%. Given that market capitalization typically reflects discounted future earnings, the current valuations imply that investors are forecasting that AT&T and Verizon will become even more dominant over time.

Under these conditions, the Commission must look to the power and behavior of parent organizations, namely AT&T and Verizon, to understand the dynamics of the wireless mobile market.

With that focus, it becomes clear that AT&T and Verizon have re-monopolized the entire telecom industry and have decided – either tacitly or otherwise – not to compete on price with respect to mobile services and not to use mobile wireless facilities to proactively attack each other's wireline business.

In contrast, the Commission should compare the price positioning of these dominant carriers when they compete against the Cable TV companies for video distribution. For example, in the Washington D.C. area, the Commissioners and staff will repeatedly hear Verizon peddle price as a major part of its FIOS sales pitch. But as the record shows, price or pricing comparisons do not factor into its mobile service ads.

VIII. AT&T and Verizon Have Routinely Violated the FCC's Merger Conditions

In its approval of the SBC-Ameritech merger, the Commission required that the combined company begin to provide business and residential local exchange service in areas outside of its service territory:

“As a condition of this merger, within 30 months of the merger closing date the combined firm will enter at least 30 major markets outside SBC's and Ameritech's incumbent service area as a facilities-based provider of local telecommunications services to business and residential customers. This will ensure that residential consumers and business customers outside of SBC/Ameritech's territory benefit from facilities-based competitive service by a major incumbent LEC. This condition effectively requires SBC and Ameritech to redeem their promise that their merger will form the basis for a new, powerful, truly nationwide multi-purpose competitive telecommunications carrier. We also anticipate that this condition will stimulate competitive entry into the

SBC/Ameritech region by the affected incumbent LECs.”

SBC did not engage in any meaningful attempt to compete outside of its region. This fact, combined with the systematic effort by the Bells to thwart competitive entry, led to the elimination of virtually all meaningful competition.

Similarly, in its Opinion and Order, the Commission found that absent conditions, the merger of Bell Atlantic and GTE would harm consumers of telecommunications services by:

- (a) denying them the benefits of future probable competition between the merging firms;
- (b) undermining the ability of regulators and competitors to implement the pro-competitive, deregulatory framework for local telecommunications...
- (c) increasing the merged entity’s incentives and ability to discriminate against entrants into the local markets of the merging firms.

The merger conditions were designed to: 1) enhance competition in the local exchange and local access market; and 2) get the new Verizon to compete out-of-territory.

Verizon undermined these conditions at every turn. Its actions resulted in the elimination of competition to the detriment of consumers, as the Commission had feared.

There are a plethora of merger conditions contained in the 10+ telecom mega-mergers of the past decade. Unfortunately, the FCC and the States could not enforce either the merger conditions or the Telecom Act on expeditious basis. The result was that the funding for competitors dried up. Verizon and AT&T had effectively eliminated the competition and any dampened any future attempts at entry.

This sequence of events, along with prior antitrust violations, raises the issue whether AT&T’s and Verizon’s behavior was premeditated, orchestrated by the executive management and coordinated among the carriers in willful violation of the FCC’s rules and regulations. The FCC should open a Formal Investigation into AT&T’s and Verizon’s behavior and practices.

IX. AT&T and Verizon Have a Long History and Culture of Antitrust Abuses

The comments in this proceeding provide an overview of the culture and antitrust abuses of the Bell System covering more than one hundred years.

In a nutshell, the Bell System has a patented and successful approach to maintaining its dominant position:

- a) Consolidate the market
- b) Discriminate against competitors in violation of the antitrust rules
- c) Enter into a Consent Decree, agreeing to a divestiture and/or market restrictions
- d) Get Congress to vacate the Consent Decree
- e) Wait for an economic downturn to re-consolidate the industry

This approach is well underway again with AT&T and Verizon now, once again, discriminating against competitors and colluding on price and market entry.

At a minimum, the Commission should investigate AT&T's and Verizon's internal documents regarding mobile service pricing and market entry and depose its executives.

X. Conclusion

The record in this proceeding is clear in many respects, including:

- 1) The Bell System has a long history of violating the antitrust laws;
- 2) AT&T and Verizon have, once again, consolidated the telecom industry and are now the dominant providers in a highly concentrated telecom industry, including mobile services;
- 3) AT&T and Verizon have routinely violated the FCC's merger conditions and other pro-competitive rules and regulations as they consolidated the market;
- 4) AT&T and Verizon have agreed – either tacitly or otherwise – a) not to pursue systematic plans to attack the other's wireline business and b) not to compete on price in the mobile sector of the market;
- 5) AT&T's and Verizon's mobile business units have unreasonably high costs, cash operating margins and prices; and
- 6) The high prices for mobile service insulate the wireline services of AT&T and Verizon from further substitution effects, thereby leading to higher landline prices and less service innovation than would otherwise be the case.

What is less clear is the degree, if at all, to which the executive management at Verizon and AT&T developed and coordinated unlawful activities leading to this outcome. Nevertheless, the pricing matrix provided by Verizon's expert witness shows a striking degree of price collusion among the carriers.

Given the magnitude of resulting overpayments by consumers, the FCC has an obligation to conduct a formal investigation into AT&T's and Verizon's pricing and market entry strategies - or refer the matter to the Department of Justice.

In the interim, the FCC should bar all non-network interconnection and non-public safety communications and coordination between AT&T and Verizon, including communications through third parties such as industry associations.

If the Commission or DOJ finds that AT&T and/or Verizon willfully violated the law and colluded on price or market entry restraints, the FCC ought to find these carriers unfit to hold mobile wireless spectrum.

Finally, if the FCC chooses not to pursue this approach, consumers will continue to overpay for mobile service by as much as \$75 billion a year attributable to an absence of competitive price rivalry among the holders of scarce spectrum. To address these overpayments, the FCC should seek authority to recoup the value of the initial 25 MHz cellular licenses by charging the licensees of this spectrum the equivalent of \$10 per MHz-POP per year on average beginning in

the next license period, scaled to reflect the greater value per POP in the larger markets.

October 5, 2009

Respectfully submitted,

A handwritten signature in dark ink, reading "Steven A. Zecola". The signature is written in a cursive style with a large, stylized 'S' and 'Z'.

Steven A. Zecola
108 Hamilton Rd.
Sterling, VA 20165
Steve@Be-Differentiated.com